ASEAN-CHINA FREE TRADE AREA, ARE WE READY?

Rini Dwi Astuti
Faculty of Economic
University of Pembangunan Nasional "Veteran" Yogyakarta
Jalan SWK 104 (Lingkar Utara), Yogyakarata 55283, Indonesia

ABSTRACT

This paper aims to analyze the readiness of ASEAN member countries and China in dealing with the implementation of ACFTA in 2015. The existing conditions being observed are macroeconomic, international trade, the private sector and the Þ nancial sector. On the macroeconomic condition (GDP per capita, inß ation and reserves) show that China with the largest GDP and reserves potentially as a driver of the market. In the international trade (exports and import of goods and services as share of GDP), Singapore has its share of trade almost quadrupling of its GDP. Private and public sector (Strength of Legal Rights Index Ease of Doing Business Index and Global Competitiveness Index) shows that Singapore is a country that is most conducive to doing business. On the Þ nancial sector (lending rate and domestic credit), shows lower lending rate can promote domestic credit to private sector.

1. INTRODUCTION

Economic development requires the generation of an internal saving-investment process of sizable magnitude within an economic, social, and political environment conducive to growth. Failure to develop usually has domestic causes, such as an adequate supply of savings, skilled labor, entrepreneurship, managerial talent, and infrastructure and improper macroeconomic policies. Exposure to foreign trade does spur economic development, but the main impetus must come from within. Import substitution and export promotion are two alternative trade strategies for development. For various reasons import substitution has failed, while export promotion succeeded in stimulating investment, employment, and GDP growth. For that reason, many countries are instituting reforms that involve less government intervention in the economy and that promote integration into the global economy. Economic integration and free trade area among countries in Asia (ASEAN) PaciÞ c (China) largely designed to create a wider internal market (Kreinin, 2002).

The ASEAN–China Free Trade Area (ACFTA), also known as China–ASEAN Free Trade Area is a free trade area among the ten member states of the Association of Southeast Asian Nations (ASEAN) and the People's Republic of China. The initial framework agreement was signed on 4 November 2002 in Phnom Penh, Cambodia, with the intent on establishing a free trade area among the eleven nations by 2010. The free trade area came into effect on 1 January 2010. The ASEAN–China Free Trade Area is the largest free trade area in terms of population and third largest in terms of nominal GDP (www.wikipedia.org). In ACFTA, China has 77.65 percent of total GDP and 70.98 percent of total population ACFTA members (Table 1).

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Table 1. GDP and Population ASEAN and China, 2011

No	Country	Income Level	2011 GDP (US $)	%	Population	%
1	Brunei Darussalam	high income	16,359,795,686	0.17	0.406	0.02
2	Cambodia	low income	12,829,541,141	0.14	14.31	0.76
3	China	upper middle income	7,318,499,269,769	77.65	1,344	70.98
4	Indonesia	lower middle income	846,832,282,925	8.99	242.3	12.80
5	Laos	lower middle income	8,297,664,741	0.09	6.288	0.33
6	Malaysia	upper middle income	287,936,971,621	3.06	28.86	1.52
7	Myanmar	na	na	na	na	na
8	Philippines	lower middle income	224,753,579,833	2.38	94.85	5.01
9	Singapore	high income	239,699,598,462	2.54	5.184	0.27
10	Thailand	upper middle income	345,672,232,116	3.67	69.52	3.67
11	Vietnam	lower middle income	123,600,141,396	1.31	87.84	4.64
	Total		**9,424,481,077,690**	**100**	**1,894**	**100**

na : data not available
Source: World Bank

The free trade agreement reduced tariffs on 7,881 product categories, or 90 percent of imported goods, to zero. This reduction took effect in China and the six original members of ASEAN: Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand. The remaining four countries will follow suit in 2015. The average tariff rate on Chinese goods sold in ASEAN countries decreased from 12.8 to 0.6 percent on 1 January 2010 pending implementation of the free trade area by the remaining ASEAN members. Meanwhile, the average tariff rate on ASEAN goods sold in China decreased from 9.8 to 0.1 percent. The six original ASEAN members also reduced tariffs on 99.11 percent of goods traded among them to zero (www.wikipedia.org).

ACFTA will not give any advantage for any country if the readiness of the country is not built. Moreover, facing trade opponents such as China that is already far ahead. ACFTA is the opportunity, but the opportunity must be meets preparedness. Every country must be realized that free trade arrangement is a win-win solution for any country and the economic will better off.

2. ECONOMIC INTEGRATION

Economic integration can be seen as the process by which two or more countries join in a closer economic relationship compared to the one maintained by each partner with the rest of the world. It is not always clear how this differs from economic cooperation in the sense that all forms of integration can be seen as forms of economic cooperation. However, while cooperation has a wider application and is limited to trade agreements, the integration goes beyond the movement of goods, services and production factors. It includes the economic dismantlement of economic frontiers such as tariffs and immigration control, and aims to raise the general economic level of life in participating countries, especially when it leads to the substitution of high-cost domestic production by imports from other member countries parties to the agreement. Moreover, the theory of economic integration refers to a commercial policy of deliberately reducing or eliminating trade barriers among the countries that joined an integration initiative, so as to allow larger specialization of the member countries through the intensiÞ cation of trade. Kritzinger (2013) identity some traditional and non- traditional gains from economic integration:

a. trade gains: If goods are sufÞ ciently strong substitutes, regional trade agreements will cause the demand for third party goods to decrease, which will drive down prices. In addition, more acute competition in the trade zone may induce outside Þ rms to cut prices to maintain exports to the region. This will create a positive terms of trade effect for member countries

b. increased returns and increased competition: Within a tiny market, there may be a trade-off between economies of scale and competition. Market enlargement removes this trade-off and makes possible the existence of (i) larger Þ rms with greater productive efÞ ciency for any industry with economies of scale and (ii) increased competition that induces Þ rms to cut prices, expand sales and reduce internal inefÞ ciencies.

c. investment: Regional trade agreements may attract FDI both from within and outside the regional integration arrangement as a result of (i) market enlargement (particularly for "lumpy" investment that might only be viable above a certain size), and (ii) production rationalization (reduced distortion and lower marginal cost in production). Enlarging a sub-regional market will also bring *direct foreign investment* , which will be beneÞ cial, provided that the incentive for foreign investors is not to engage in "tariff-jumping". This advocates once again for the necessity to reduce protection and more speciÞ cally external tariffs.

The international economic integration can also have the political purpose of strengthening the relations of security, peace and good neighborhood between the participating countries (Chichava, 2013). Countries can coordinate their positions, they will stand in multilateral negotiations (e.g. World Trade Organization - WTO) with at least more visibility and possibly stronger bargaining power. The *collective bargaining power* argument is especially relevant for the poor and fractioned countries within a sub-region. It may help countries to develop common positions and to bargain as a group rather than on a country by country basis, which would contribute to increased visibility, credibility and even better negotiation outcomes. It also may increase intra-regional trade and investment and also link countries in a web of positive interactions and interdependency. This is likely to build trust, raise the opportunity cost of war, and hence reduce the risk of conß icts between countries (Kritzinger, 2013).

3. EXISTING CONDITIONS

3.1. MACROECONOMICS

GDP per Capita

GDP per capita is gross domestic product divided by midyear population. GDP is the sum of gross value added by all resident producers in the economy plus any product taxes and minus any subsidies not included in the value of the products. It is calculated without making deductions for depreciation of fabricated assets or for depletion and degradation of natural resources Dollar Þ gures for GDP is converted from domestic currencies using single year ofÞ cial exchange rates (www.worldbank.org).

ACFTA countries have a variation in the amount of GDP per capita (Table 2). There are two high-income countries, Brunei Darussalam and Singapore and one low-income country, Cambodia. The rest is the middle income countries. Three countries are upper middle income (China, Malaysia, and Thailand) and four lower middle income countries (Indonesia, Laos, Philippines, and Vietnam). The opportunity of ACFTA can increase GDP per capita from increasing export and lower price of raw material that can reduce production cost.

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Table 2. GDP per Capita, Inflation, and Total Reserve ASEAN and China, 2011

No	Country	2011 GDP per Capita (US$)	%	Inflation (%)	Total Reserves (US$)	%
1	Brunei Darussalam	40,301	35	2	2,583,675,749	0.06
2	Cambodia	897	1	5.5	4,061,785,443	0.10
3	China	5,445	5	5.4	3,254,674,122,432	80.94
4	Indonesia	3,495	3	5.4	110,136,605,627	2.74
5	Laos	1,320	1	7.6	1,178,202,761	0.03
6	Malaysia	9,977	9	3.2	133,571,691,894	3.32
7	Myanmar	na	-	5	7,361,702,606	0.18
8	Philippines	2,370	2	4.6	75,123,093,542	1.87
9	Singapore	46,241	40	5.3	243,798,278,361	6.06
10	Thailand	4,972	4	3.8	174,891,027,448	4.35
11	Vietnam	1,407	1	18.7	13,539,120,120	0.34
	Total	116,425	100	-	4,020,919,305,983	100
	Average	11,643	-	6.0	365,538,118,726	-

na = data not available

Source: World Bank

Inflation

Inflation as measured by the consumer price index (CPI) reflects the annual percentage change in the cost to the average consumer of acquiring a basket of goods and services that may be fixed or changed at specified intervals, such as yearly (www.worldbank.org). The average inflation of ACFTA member countries in 2011 is 6 percent (Table 2). Almost all countries have inflation below average, only Laos and Vietnam which have inflation above average. Vietnam has the highest inflation in the double digits, so that the monetary authorities should be able to reach Vietnam inflation at a lower level. High inflation may lead to domestic goods uncompetitive in the international market. The ability of monetary authorities to maintain price stability is a prerequisite ACFTA member countries can compete in international markets.

Total Reserves

Total reserves comprise holdings of monetary gold, special drawing rights, reserves of IMF members held by the IMF, and holdings of foreign exchange under the control of monetary authorities. The gold component of these reserves is valued at year-end (December 31) London prices (www.worldbank.org). China has the highest reserves, amounting to 81 percent of the total reserves ACFTA countries (Table 2). Total reserves important indicators, especially in the era of the rise of global financial flows in the financial sector in the form of portfolio investment. The total reserves needed to maintain the exchange rate, if foreign funds are disbursed and a short-term re-taken out by foreign investors. The reserves limitation is a major constraint for investment grade of government bonds in foreign exchange. Total reserve increased by increasing exports and capital inflows, portfolio and foreign direct investment (FDI). To take the opportunity of ACFTA, FDI must be imposed to the sector which country have a competitive advantage and increase productivity and expand the market.

3.2. INTERNATIONAL TRADE

Trade

Trade is the sum of exports and imports of goods and services measured as a share of gross domestic product (www.worldbank.org). Table 3 shows four countries with trade exceeding the average, which is Malaysia, Singapore, Thailand, and Vietnam. Singapore was the highest trading, which almost four time GDP. ACFTA is expected to boost trade of the rest countries, including China which has the highest GDP and reserve.

Exports and Import of Goods and Services

Exports and import of goods and services include the value of merchandise, freight, insurance, transport, travel, royalties, license fees, and other services, such as communication, construction, Þ nancial, information, business, personal, and government services. They exclude compensation of employees and investment income (formerly called factor services) and transfer payments (www.worldbank.org). Table 3 shows Indonesia has a lowest exports and imports of goods and services as a share of gross domestic product. Economic growth in Indonesia mostly support by domestic consumption. All countries have a surplus balance (exports exceed imports) except Cambodia, Laos, Philippines, and Vietnam have a deÞ cit balance (imports exceed exports).

Table 3. Export and Import ASEAN and China, 2011

No	Country	2011 Trade (% of GDP)	Export (% of GDP)	Import (% of GDP)
1	Brunei Darussalam	110	81	29
2	Cambodia	114	54	60
3	China	59	31	27
4	Indonesia	51	26	25
5	Laos	82	38	44
6	Malaysia	167	92	76
7	Philippines	67	31	36
8	Singapore	391	209	182
9	Thailand	149	77	72
10	Vietnam	178	87	91
	Average	136.8	72.6	64.2

Source: World Bank

Documents to Export or Import

All documents required per shipment to export/import goods are recorded. It is assumed that the contract has already been agreed upon and signed by both parties. Documents required for clearance by government ministries, customs authorities, port and container terminal authorities, health and technical control agencies and banks are taken into account. Since payment is by letter of credit, all documents required by banks for the issuance or securing of a letter of credit are also taken into account. Documents that are renewed annually and that do not require renewal per shipment (for example, an annual tax clearance certiÞ cate) are not included (www.worldbank.org). Table 4 shows Laos has the most document being used to exports and imports (10 documents) and the least document being used to exports and imports is Singapore (10 documents).

Table 4. Documents, Time, and Cost International Trade ASEAN and China, 2012

No	Country	Documents to Export (number)	Documents to import (number)	2012 Time	Cost to Export
1	Brunei Darussalam	6	6	19	680
2	Cambodia	9	10	22	755
3	China	8	5	21	580
4	Indonesia	4	7	17	644
5	Laos	10	10	26	2140
6	Malaysia	5	6	11	435
7	Philippines	7	8	15	585
8	Singapore	4	4	5	456
9	Thailand	5	5	14	585
10	Vietnam	6	8	21	610
	Average	**6.4**	**6.9**	**17.1**	**747**

Source: World Bank

Time to Export

Time is recorded in calendar days. The time calculation for a procedure starts from the moment it is initiated and runs until it is completed. If a procedure can be accelerated for an additional cost, the fastest legal procedure is chosen. It is assumed that neither the exporter nor the importer wastes time and that each commits to completing each remaining procedure without delay. Procedures that can be completed in parallel are measured as simultaneous. The waiting time between procedures--for example, during unloading of the cargo--is included in the measure (www.worldbank.org). Table 4 shows Singapore has a shortest day (5 days) to completing procedures. Only three countries (Malaysia, Philippines and Thailand) have a time to export under average. The longest day is Laos (26 days).

Cost to Export

Cost measures the fees levied on a 20-foot container in U.S. dollars. All the fees associated with completing the procedures to export or import the goods are included. These include costs for documents, administrative fees for customs clearance and technical controls, customs broker fees, terminal handling charges and inland transport. The cost measure does not include tariffs or trade taxes. Only ofÞ cial costs are recorded. Several assumptions are made for the business surveyed: Has 60 or more employees; located in the country's most populous city; a private, limited liability company. It does not operate within an export processing zone or an industrial estate with special export or import privileges; domestically owned with no foreign ownership; Exports more than 10% of its sales. Assumptions about the traded goods: The traded product travels in a dry-cargo, 20-foot, full container load. The product: Is not hazardous nor does it include military items; Does not require refrigeration or any other special environment; Does not require any special phytosanitary or environmental safety standards other than accepted international standards (www.worldbank. org). Cost to export in Laos about three times average cost (Table 4).

3.3. PRIVATE SECTOR

Strength of Legal Rights Index

Strength of legal rights index measures the degree to which collateral and bankruptcy laws protect the rights of borrowers and lenders and thus facilitate lending. The index ranges from 0 to 10 (0=weak to 10=strong), with higher scores indicating that these laws are better designed to expand access to credit (www.

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worldbank.org). Table 5 shows Malaysia and Singapore have the best Strength of Legal Rights Index (10 points), and Indonesia the worst (3 points).

Ease of Doing Business Index

Ease of doing business ranks economies from 1 to 185, with Þ rst place being the best (1=most business-friendly regulations). A high ranking (a low numerical rank) means that the regulatory environment is conducive to business operation. The index averages the country's percentile rankings on 10 topics covered in the World Bank's Doing Business. The ranking on each topic is the simple average of the percentile rankings on its component indicators (www.worldbank.org). Table 5 shows Singapore is the most business-friendly regulations (rank 1) and Laos has not conducive regulatory environment to business operation (rank 163). The only three countries with the rank under twenty, Singapore (rank 1), Malaysia (rank 12) and Thailand (rank 18).

Table 5. Private Sector Index ASEAN and China, 2010 and 2012

No	Country	Legal Right 2010	Doing Business 2012	Global Competitiveness
1	Brunei Darussalam	7	79	2
2	Cambodia	8	133	8
3	China	6	91	2
4	Indonesia	3	128	5
5	Laos	4	163	-
6	Malaysia	10	12	2
7	Philippines	4	138	6
8	Singapore	10	1	2
9	Thailand	5	18	3
10	Vietnam	8	99	7

Source: World Bank, World Economic Forum (2012)

InefÞ cient bureaucracy, such as mechanism of application permits that are often cumbersome and time consuming can affects not only psychological, which weaken the ethos and spirit of entrepreneurship in the society, but also repel investors to make investment.

Global Competitiveness Index

Global competitiveness index ranks economies from 1 to 144 measure indicators of institutions, infrastructure, macroeconomic environment, health and primary education, higher education and training, markets efÞ ciency (goods, labor, and Þ nancial markets), technological readiness, market size, business sophistication and innovation. Quoting the data of the World Economic Forum (2012), Singapore placed in the 2nd position. Indonesia placed in the 50th position far below Malaysia (rank 25), Brunei Darussalam (rank 28) and China (rank 29).

3.4. FINANCIAL SECTOR

Lending Rate

Lending rate is the bank rate that usually meets the short- and medium-term Þ nancing needs of the private sector. This rate is normally differentiated according to creditworthiness of borrowers and objectives of Þ nancing (www.worldbank.org). Real interest rate is the lending interest rate adjusted for inß ation as measured by the CPI. Table 6 shows Indonesia, Laos, Myanmar and Vietnam have a double digit lending rate. It can reduce domestic credit provided by banking sector, except Vietnam due to negative real interest. The lower lending rate will be able to stimulate business and economic growth.

Table 6. Lending Rate, Real Interest Rate, Domestic Credit ASEAN and China, 2011

No	Country	2011			
		Lending Rate (%)	**Real Interest Rate (%)**	**Domestic Credit to Private Sector (% of GDP)**	**Domestic Credit Provided by Banking Sector (% of GDP)**
1	Brunei Darussalam	5.5	3.5	31.8	8.1
2	Cambodia	na	na	28.3	24.2
3	China	6.6	1.2	127	145.5
4	Indonesia	12.4	7	31.7	38.5
5	Laos	22.6 (2010)	na	20.8(2010)	26.5(2010)
6	Malaysia	4.9	1.7	112.2	128.7
7	Myanmar	16.3	11.3	na	na
8	Philippines	6.7	2.1	31.8	51.8
9	Singapore	5.4	0.1	112.6	93.6
10	Thailand	6.9	3.1	140.1	159
11	Vietnam	17	-1.7	111.6	120.9

na = data not available
Source: World Bank

Domestic Credit to Private Sector

Domestic credit to private sector refers to Þ nancial resources provided to the private sector, such as through loans, purchases of non equity securities, and trade credits and other accounts receivable, that establish a claim for repayment (www.worldbank.org). Table 6 shows China, Malaysia, Singapore, Thailand and Vietnam have more domestic credit to private sector as share of GDP (above 110 percent). Other countries have less share of GDP (less than 32 percent).

Domestic Credit Provided by Banking Sector

Domestic credit provided by the banking sector includes all credit to various sectors on a gross basis, with the exception of credit to the central government, which is net. The banking sector includes monetary authorities and deposit money banks, as well as other banking institutions where data are available (including institutions that do not accept transferable deposits but do incur such liabilities as time and savings deposits). Examples of other banking institutions are savings and mortgage loan institutions and building and loan associations (www.worldbank.org). Table 6 shows China has the most domestic credit provided by the banking sector as share of GDP (146 percent). In Indonesia, the slightly of domestic credit provided by banking sector because of some limited credit access especially for small and micro enterprises, whereas this type of business is the most accommodating for labor. An estimated 80-90 percent of the workforces are relying on this sector.

4. CONCLUSION

Existing condition of the countries within regional integration (ACFTA) were identiÞ ed, as well as the measures to be taken to transform the competitive disadvantages into opportunities that may allow a successful process of convergence and economic integration. It is hardly required a stability of macroeconomic, more efÞ cient procedures of international trading (in order to maintain and improve the competitiveness of national products as well as securing the domestic market), a conducive regulatory environment to business operation

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(including infrastructure, good governance and effective public service, bureaucratic reform and cutting the high cost economy, law enforcement and corruption eradication) and Þ nancial policies and bank interest rate that is competitive. It can be done with coordination macroeconomic policy between central bank who is in charge in monetary policy and government who is in charge in Þ scal and real sector policy.

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